

EXHIBIT 37

COPY

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ENDORSED
FILED
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KELLY-MOORE PAINT COMPANY, INC.

PLAN 1
MAR 08 2002
RECEIVED DATE

SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF SAN FRANCISCO

323147

KELLY-MOORE PAINT COMPANY, INC.,)
Plaintiff,)

v.)

LIBERTY MUTUAL INSURANCE CO.;)
CONTINENTAL INSURANCE CO.; THE)
NORTH RIVER INSURANCE CO.;)
INSURANCE COMPANY OF NORTH)
AMERICA; AMERICAN HOME)
ASSURANCE CO.; CONTINENTAL)
CASUALTY CO.; MISSION INSURANCE)
CO.; FEDERAL INSURANCE CO.; FIRST)
STATE INSURANCE CO.; U.S. FIRE)
INSURANCE CO.; AMERICAN EXCESS)
INSURANCE CO.; INTERSTATE FIRE &)
CASUALTY CO.; TRANSPORT)
INDEMNITY CO.; INTEGRITY)
INSURANCE CO.; and DOES 1-50,)
inclusive,)

Defendants.)

Case No. _____

COMPLAINT FOR BREACH OF
CONTRACT, BREACH OF THE
IMPLIED COVENANT OF GOOD
FAITH AND FAIR DEALING, AND
DECLARATORY RELIEF; DEMAND
FOR JURY TRIAL

1 Plaintiff KELLY-MOORE PAINT COMPANY, INC., alleges as follows:

2 **GENERAL ALLEGATIONS**

3 1. At all materials times herein, plaintiff KELLY-MOORE PAINT
4 COMPANY, INC. ("KELLY-MOORE") was and is a corporation incorporated in the
5 State of California, operating a paint and building materials manufacturing business,
6 with its principal place of business in San Carlos, California.

7 2. Plaintiff is informed and believes that at all material times herein,
8 defendant LIBERTY MUTUAL INSURANCE COMPANY ("LIBERTY MUTUAL")
9 was and is a corporation or other business entity authorized to transact, and
10 transacting, insurance business in the State of California. LIBERTY MUTUAL is a
11 Massachusetts mutual insurance company with its principal place of business in
12 Boston, Massachusetts.

13 3. Plaintiff is informed and believes that at all material times herein,
14 defendant THE NORTH RIVER INSURANCE COMPANY ("NORTH RIVER") was
15 and is a corporation or other business entity authorized to transact, and transacting,
16 insurance business in the State of California. NORTH RIVER is a New Jersey
17 corporation with its principal place of business in Morristown, New Jersey.

18 4. Plaintiff is informed and believes that at all material times herein,
19 defendant CONTINENTAL INSURANCE COMPANY ("CONTINENTAL") was and
20 is a corporation or other business entity authorized to transact, and transacting,
21 insurance business in the State of California. CONTINENTAL is a New Hampshire
22 corporation with its principal place of business in Chicago, Illinois.

23 5. Plaintiff is informed and believes that at all material times herein,
24 defendant INSURANCE COMPANY OF NORTH AMERICA ("INA") was and is a
25 corporation or other business entity authorized to transact, and transacting,
26

1 insurance business in the State of California. INA is a Pennsylvania corporation with
2 its principal place of business in Philadelphia, Pennsylvania.

3 6. Plaintiff is informed and believes that at all material times herein,
4 defendant AMERICAN HOME ASSURANCE COMPANY ("AMERICAN HOME")
5 was and is a corporation or other business entity authorized to transact, and
6 transacting, insurance business in the State of California. AMERICAN HOME is a
7 New York corporation with its principal place of business in New York, New York.

8 7. Plaintiff is informed and believes that at all material times herein,
9 defendant CONTINENTAL CASUALTY COMPANY ("CONTINENTAL
10 CASUALTY") was and is a corporation or other business entity authorized to
11 transact, and transacting, insurance business in the State of California.
12 CONTINENTAL CASUALTY is an Illinois corporation with its principal place of
13 business in Chicago, Illinois.

14 8. Plaintiff is informed and believes that at all material times herein,
15 defendant MISSION INSURANCE COMPANY ("MISSION") was and is a
16 corporation or other business entity authorized to transact, and transacting,
17 insurance business in the State of California. MISSION is a California corporation
18 with its principal place of business in Long Beach, California, and is currently in
19 liquidation.

20 9. Plaintiff is informed and believes that at all material times herein,
21 defendant FEDERAL INSURANCE COMPANY ("FEDERAL") was and is a
22 corporation or other business entity authorized to transact, and transacting,
23 insurance business in the State of California. FEDERAL is a New Jersey corporation
24 with its principal place of business in Warren, New Jersey.

25 10. Plaintiff is informed and believes that at all material times herein,
26 defendant FIRST STATE INSURANCE COMPANY ("FIRST STATE") was and is a

1 corporation or other business entity authorized to transact, and transacting,
2 insurance business in the State of California. FIRST STATE is a Delaware corporation
3 with its principal place of business in Boston, Massachusetts.

4 11. Plaintiff is informed and believes that at all material times herein,
5 defendant U.S. FIRE INSURANCE COMPANY ("U.S. FIRE") was and is a
6 corporation or other business entity authorized to transact, and transacting,
7 insurance business in the State of California. U.S. FIRE is a New York corporation
8 with its principal place of business in Morristown, New Jersey.

9 12. Plaintiff is informed and believes that at all material times herein,
10 defendant AMERICAN EXCESS INSURANCE COMPANY ("AMERICAN EXCESS")
11 was and is a corporation or other business entity authorized to transact, and
12 transacting, insurance business in the State of California. AMERICAN EXCESS is a
13 Delaware corporation with its principal place of business in New York, New York.

14 13. Plaintiff is informed and believes that at all material times herein,
15 defendant INTERSTATE FIRE & CASUALTY COMPANY ("INTERSTATE") was and
16 is a corporation or other business entity authorized to transact, and transacting,
17 insurance business in the State of California. INTERSTATE is an ILLINOIS
18 corporation with its principal place of business in Chicago, Illinois.

19 14. Plaintiff is informed and believes that at all material times herein,
20 Defendant TRANSPORT INDEMNITY COMPANY ("TRANSPORT") was and is a
21 corporation or other business entity authorized to transact, and transacting,
22 insurance business in the State of California. TRANSPORT is a California
23 corporation with its principal place of business in Los Angeles, California.

24 15. Plaintiff is informed and believes that at all material times herein,
25 Defendant INTEGRITY INSURANCE COMPANY ("INTEGRITY") was and is a
26 corporation or other business entity authorized to transact, and transacting,

1 insurance business in the State of California. INTEGRITY is a New Jersey
2 corporation with its principal place of business in Paramus, New Jersey, and is
3 currently in liquidation.

4 16. Plaintiff is ignorant of the true names and capacities of defendants sued
5 herein as DOES 1-50, inclusive, and therefore sues these defendants by said fictitious
6 names. Plaintiff is informed and believes, and thereon alleges, that said fictitiously
7 named defendants are responsible in some manner for the events and happenings
8 herein referred to, and negligently or otherwise caused injuries and damages
9 proximately thereby to plaintiff as herein alleged.

10 17. At all material times herein, each of the named and fictitiously named
11 defendants was acting individually or as agent, servant and employee of each of his,
12 her, or its co-defendants, and at all of said times each of said named or fictitiously
13 named defendants was acting within the scope of said agency, service and
14 employment. At all relevant times, each of the acts of each of the said defendants
15 was ratified by each of the other said defendants.

16 **THE "ASBESTOS LITIGATION"**

17 18. KELLY-MOORE, through its subsidiary PACO Textures Corporation
18 ("PACO"), manufactured asbestos-containing building materials from
19 approximately 1960 to 1978.

20 19. Tens of thousands of claimants in a number of jurisdictions have
21 brought bodily injury actions against KELLY-MOORE relating to alleged exposure
22 to PACO asbestos-containing products (the "Asbestos Litigation"). The Asbestos
23 Litigation claimants either do not specify the dates of their exposure to PACO
24 asbestos-containing products or allege that exposure occurred prior to October 1,
25 1984.

INSURANCE POLICIES

20. LIBERTY MUTUAL, INA, U.S. FIRE, and several other insurance carriers issued certain primary liability insurance policies to KELLY-MOORE with effective dates from approximately January 1, 1956 to October 1, 1984. Each of these primary liability policies provided defense and indemnity coverage to KELLY-MOORE for bodily injury claims, including the asbestos-related personal injury claims that comprise the Asbestos Litigation.

21. KELLY-MOORE is informed and believes, and thereon alleges, that the bodily injury products liability aggregate limits of each of the primary liability insurance policies are exhausted.

22. LIBERTY MUTUAL, CONTINENTAL, NORTH RIVER, INA, AMERICAN HOME, and MISSION issued first-layer excess liability insurance policies to KELLY-MOORE with effective dates from approximately January 1, 1966 to October 1, 1984. Attached hereto as Exhibit "A" and incorporated herein by reference is a schedule which lists each first-layer excess policy that KELLY-MOORE is informed and believes LIBERTY MUTUAL, CONTINENTAL, NORTH RIVER, INA, AMERICAN HOME, and MISSION issued to KELLY-MOORE. Each of these first-layer excess liability policies provided defense and indemnity coverage to KELLY-MOORE for bodily injury claims, including the asbestos-related personal injury claims that comprise the Asbestos Litigation, for sums in excess of the policy limits of the underlying primary liability policies.

23. KELLY-MOORE is informed and believes, and thereon alleges, that based upon preliminary projections of its asbestos-related liabilities arising out of the Asbestos Litigation, the bodily injury products liability aggregate limits of each of the first-layer excess liability insurance policies listed in Exhibit A will be exhausted presently.

24. CONTINENTAL CASUALTY, FEDERAL, FIRST STATE, U.S. FIRE, AMERICAN EXCESS, INTERSTATE, TRANSPORT, and INTEGRITY issued second-layer and third-layer excess liability insurance policies to KELLY-MOORE with effective dates from approximately June 24, 1977 to October 1, 1984. Attached hereto as Exhibit "B" and incorporated herein by reference is a schedule which lists each second-layer and third-layer excess policy that KELLY-MOORE is informed and believes CONTINENTAL CASUALTY, FEDERAL, FIRST STATE, U.S. FIRE, AMERICAN EXCESS, INTERSTATE, TRANSPORT, and INTEGRITY issued to KELLY-MOORE. Each of these second-layer and third-layer excess liability policies provided defense and indemnity coverage to KELLY-MOORE for bodily injury claims, including the asbestos-related personal injury claims that comprise the Asbestos Litigation, for sums in excess of the policy limits of the underlying excess liability policies.

25. KELLY-MOORE is informed and believes, and thereon alleges, that based upon preliminary projections of its asbestos-related liabilities arising out of the Asbestos Litigation, the bodily injury products liability aggregate limits of each of the second-layer and third-layer excess liability insurance policies listed in Exhibit B will be impacted in the near future.

FIRST CAUSE OF ACTION

(Breach of Contract Against Liberty Mutual and Continental)

26. Plaintiff incorporates by reference paragraphs 1 through 25 and realleges said allegations as though here fully set forth.

27. From approximately January 1, 1974 to May 22, 1978, LIBERTY MUTUAL insured KELLY-MOORE under certain umbrella excess liability policies, including, without limitation, the following: (a) Policy No. LE1-161-015355-054, with a policy period from January 1, 1974 to January 1, 1975, with per occurrence and

1 aggregate policy limits of \$10 million; (b) Policy No. LE1-161-015355-104 (designated
2 as a "rewrite" of Policy No. LE1-161-015355-054), with a policy period from May 1,
3 1974 to January 1, 1975, with per occurrence and aggregate policy limits of \$10
4 million; (c) Policy No. LE1-161-015355-105, with a policy period from May 1, 1975 to
5 May 1, 1976, with per occurrence and aggregate policy limits of \$10 million; (d)
6 Policy No. LE1-161-015355-106, with a policy period from May 1, 1976 to May 1,
7 1977, with per occurrence and aggregate policy limits of \$10 million; (e) Policy No.
8 LE1-161-015355-107, with a policy period from May 1, 1977 to May 1, 1978, with per
9 occurrence and aggregate policy limits of \$10 million; and (f) Policy No. LE1-161-
10 015355-108, with a policy period from May 1, 1978 to May 22, 1978, with per
11 occurrence and aggregate policy limits of \$10 million (collectively referred to as the
12 "LIBERTY MUTUAL Policies").

13 28. LIBERTY MUTUAL, at all relevant times until approximately February
14 2001, acted as the "lead carrier" in defending and indemnifying KELLY-MOORE in
15 the Asbestos Litigation.

16 29. LIBERTY MUTUAL, through its agents, represented to KELLY-
17 MOORE that all of the LIBERTY MUTUAL Policies provide insurance coverage to
18 KELLY-MOORE for the Asbestos Litigation, and would provide a total of at least \$50
19 million in insurance coverage to KELLY-MOORE for indemnification of the Asbestos
20 Litigation claims. These representations were made by agents of LIBERTY
21 MUTUAL with actual or ostensible authority to make such representations, and
22 were binding upon LIBERTY MUTUAL. Officers, directors and/or managing agents
23 of LIBERTY MUTUAL made, authorized or ratified all statements and positions
24 taken by LIBERTY MUTUAL relating to the existence of at least \$50 million in
25 insurance coverage available to KELLY-MOORE for the Asbestos Litigation.

1 30. In reliance upon these representations of substantial insurance
2 coverage, KELLY-MOORE allowed LIBERTY MUTUAL to settle numerous cases
3 without any communication with or involvement by KELLY-MOORE or its defense
4 counsel.

5 31. After KELLY-MOORE had relied upon LIBERTY MUTUAL's
6 representations of \$50 million in available coverage, LIBERTY MUTUAL changed its
7 position and asserted that only \$10 million in coverage was available.

8 32. While controlling these settlement negotiations, LIBERTY MUTUAL
9 overpaid settlements in many of the claims against KELLY-MOORE, thereby
10 prematurely exhausting its claimed \$10 million policy limits. Upon exhausting the
11 claimed \$10 million policy limits, LIBERTY MUTUAL has sought to withdraw from
12 any further participation in KELLY-MOORE's defense in the Asbestos Litigation.

13 33. KELLY-MOORE is informed and believes and thereon alleges that
14 LIBERTY MUTUAL exhausted its claimed \$10 million policy limits prematurely in
15 order to avoid its obligation under the Policies to continue paying defense costs in
16 the Asbestos Litigation.

17 34. KELLY-MOORE is informed and believes and thereon alleges that
18 LIBERTY MUTUAL, acting as lead carrier, has unreasonably withheld policy benefits
19 and wrongfully handled claims by, *inter alia*, the following: failing to pay reasonable
20 defense fees and costs in a timely manner; failing to pay expert witnesses in a timely
21 manner; failing to pay settlement funds to claimants in a timely manner, thereby
22 forcing claimants to file motions to compel payment of settlement funds; failing to
23 keep KELLY-MOORE informed of settlement negotiations, despite knowing that
24 there existed a risk of excess liability to KELLY-MOORE; failing to keep defense
25 counsel for KELLY-MOORE informed of settlement negotiations; failing to
26 communicate with defense counsel about the Asbestos Litigation generally; failing

1 to seek competent legal advice on matters of settlement; disregarding competent
2 legal advice on matters of settlement; failing to evaluate claims against KELLY-
3 MOORE; failing to properly investigate claims against KELLY-MOORE; overpaying
4 settlements, thereby causing KELLY-MOORE's limits of liability to exhaust
5 prematurely, and thereby improperly raising the average value of future asbestos-
6 related personal injury settlements; and failing to give its insured's interests equal
7 consideration with its own by firing Texas defense counsel, who were highly
8 experienced in representing KELLY-MOORE in the Asbestos Litigation, over
9 KELLY-MOORE's express objections, in an effort to save defense costs, and
10 otherwise to advance LIBERTY MUTUAL's interests over those of KELLY-MOORE.

11 35. From approximately May 1, 1980 to October 1, 1983, CONTINENTAL
12 insured KELLY-MOORE under certain umbrella liability policies, including, without
13 limitation, the following: (a) Umbrella Liability Policy No. SRU 2 15 56 23, with a
14 policy period from May 1, 1980 to May 1, 1981, with per occurrence and aggregate
15 policy limits of \$20,000,000; (b) Umbrella Liability Policy No. SRU 2 15 56 65, with a
16 policy period from May 1, 1981 to May 1, 1982, with per occurrence and aggregate
17 policy limits of \$20,000,000; and (c) Umbrella Liability Policy No. SRU 2 15 57 50, with
18 a policy period from May 1, 1982 to October 1, 1983, with per occurrence and
19 aggregate policy limits of \$20,000,000 (collectively referred to herein as the
20 "CONTINENTAL Policies"). The CONTINENTAL Policies are excess to the
21 underlying primary liability policies issued by Truck Insurance Exchange for the
22 May 1, 1980 to October 1, 1983 time period.

23 36. The CONTINENTAL Policies provide both defense and indemnity
24 coverage to KELLY-MOORE for the asbestos-related personal injury claims that
25 comprise the Asbestos Litigation, in excess of the policy limits of the underlying
26 primary liability policies issued by Truck Insurance Exchange.

1 37. KELLY-MOORE has been informed by its insurers that the aggregate
2 limits of each of the primary liability policies have exhausted, including those
3 primary policies underlying the CONTINENTAL Policies, issued by Truck Insurance
4 Exchange.

5 38. KELLY-MOORE is informed and believes and thereon alleges that,
6 upon exhaustion of the primary policies, CONTINENTAL reached an agreement
7 with two of KELLY-MOORE's other excess liability insurers, LIBERTY MUTUAL and
8 NORTH RIVER, to share, on a percentage basis, payment of judgments and
9 settlements of the Asbestos Litigation claims against KELLY-MOORE.

10 39. CONTINENTAL has refused to pay KELLY-MOORE's defense costs in
11 the Asbestos Litigation.

12 40. KELLY-MOORE has duly complied with all the material terms and
13 conditions of the LIBERTY MUTUAL Policies and CONTINENTAL Policies.

14 41. KELLY-MOORE has been and is exposed to liability to pay substantial
15 sums because of alleged bodily injury in connection with the claims asserted against
16 KELLY-MOORE in the Asbestos Litigation.

17 42. KELLY-MOORE timely notified CONTINENTAL of the claims asserted
18 against KELLY-MOORE in the Asbestos Litigation, and requested that
19 CONTINENTAL investigate these claims, provide KELLY-MOORE with a defense to
20 these claims, and pay on KELLY-MOORE's behalf any sum that KELLY-MOORE
21 may be liable to pay because of alleged bodily injury relating to the Asbestos
22 Litigation.

23 43. CONTINENTAL has refused to honor its obligation to investigate and
24 to defend against the claims asserted against KELLY-MOORE in the Asbestos
25 Litigation.

44. CONTINENTAL has wrongfully refused to defend KELLY-MOORE in the Asbestos Litigation, and has breached its contractual duties to investigate and defend against claims made against KELLY-MOORE in the Asbestos Litigation, as described above.

45. LIBERTY MUTUAL has breached its contractual duties by unreasonably withholding policy benefits, failing to investigate claims, and wrongfully handling claims against KELLY-MOORE in the Asbestos Litigation, as described above.

46. By reason of LIBERTY MUTUAL's and CONTINENTAL's wrongful conduct, KELLY-MOORE has been caused to suffer and will continue to suffer substantial prejudice and damages.

47. By reason of LIBERTY MUTUAL's and CONTINENTAL's breach of contract, KELLY-MOORE has been caused to suffer and continues to suffer ongoing loss of the benefits it is due, together with interest thereon at the legal rate from the date the payment should have been made under the terms of the respective LIBERTY MUTUAL and CONTINENTAL Policies until it is paid.

WHEREFORE, plaintiff prays judgment against defendants LIBERTY MUTUAL and CONTINENTAL, as hereinafter set forth.

SECOND CAUSE OF ACTION

(Breach of the Implied Covenant of Good Faith and Fair Dealing Against Liberty Mutual and Continental)

48. Plaintiff incorporates by reference paragraphs 1 through 47 and realleges said allegations as though here fully set forth.

49. Implied in each insurance policy is a covenant by the insurer that it will act in good faith and fair dealing with its insured; that it will do nothing to interfere with the right of its insured to receive the benefits of the policy; that it will give at

1 least as much consideration to the interests of its insured as it gives to its own
2 interests; that it will investigate all possible bases for coverage; and that it will deny
3 no claim without thoroughly investigating the foundation for the denial and at all
4 times deal in good faith with its insured (hereinafter referred to as "the implied
5 covenant of good faith and fair dealing").

6 50. At all material times herein, LIBERTY MUTUAL has violated its
7 covenant of good faith and fair dealing by, *inter alia*, the following:

- 8 (a) Consciously and unreasonably failing to properly investigate
9 the claims against KELLY-MOORE fairly and in good faith, and
10 refusing to give the insured's interests equal consideration with its
11 own;
- 12 (b) Consciously and unreasonably failing to pay reasonable defense
13 fees and costs in a timely manner;
- 14 (c) Consciously and unreasonably failing to pay expert witnesses in
15 a timely manner;
- 16 (d) Consciously and unreasonably failing to pay settlement funds
17 to claimants in a timely manner, thereby forcing claimants to file
18 motions to compel payment of settlement funds;
- 19 (e) Consciously and unreasonably failing to keep KELLY-MOORE
20 informed of settlement negotiations, despite knowing that there
21 existed a risk of excess liability to KELLY-MOORE;
- 22 (f) Consciously and unreasonably failing to keep defense counsel
23 for KELLY-MOORE informed of settlement negotiations;
- 24 (g) Consciously and unreasonably failing to communicate with
25 defense counsel about the Asbestos Litigation generally;
- 26

(h) Consciously and unreasonably failing to seek competent legal advice on matters of settlement, and disregarding competent legal advice on matters of settlement;

(i) Consciously and unreasonably failing to properly evaluate claims against KELLY-MOORE;

(j) Consciously and unreasonably failing to give its insured's interests equal consideration with its own by overpaying settlements, thereby causing KELLY-MOORE's insurance coverage to exhaust prematurely, and thereby improperly raising the average value of future asbestos-related personal injury settlements;

(k) Consciously and unreasonably failing to give its insured's interests equal consideration with its own by firing Texas defense counsel, who were highly experienced in representing KELLY-MOORE in the Asbestos Litigation, over KELLY-MOORE's express objections, in an effort to save defense costs, and otherwise to advance LIBERTY MUTUAL's interests over those of KELLY-MOORE; and

(l) Consciously and unreasonably embarking on an interpretation of the facts and policy provisions calculated to deprive KELLY-MOORE of coverage when LIBERTY MUTUAL knew that KELLY-MOORE was and is entitled to full coverage under each of the LIBERTY MUTUAL policies.

51. At all material times herein, CONTINENTAL has violated its covenant of good faith and fair dealing by, *inter alia*, the following:

(a) Consciously and unreasonably refusing to pay KELLY-MOORE benefits to which it is entitled pursuant to the CONTINENTAL Policies, and depriving KELLY-MOORE of its rightful benefits with the

1 knowledge that said denials were and are wrongful and contrary to
2 CONTINENTAL's obligations under the CONTINENTAL Policies and
3 the law;

4 (b) Consciously and unreasonably failing to properly investigate
5 KELLY-MOORE's claim fairly and in good faith and refusing to give
6 KELLY-MOORE's interests at least as much consideration as
7 CONTINENTAL gave its own;

8 (c) Consciously and unreasonably refusing to make payment to
9 KELLY-MOORE, with the intent of saving itself money at KELLY-
10 MOORE's expense;

11 (d) Consciously and unreasonably denying coverage without
12 thoroughly investigating the foundation for its denial; and

13 (e) Consciously and unreasonably embarking on an interpretation
14 of the facts and policy provisions calculated to deprive KELLY-MOORE
15 of coverage when CONTINENTAL knew that KELLY-MOORE was
16 and is entitled to coverage.

17 52. KELLY-MOORE is informed and believes and thereon alleges that the
18 aforementioned conduct is a common pattern and practice on the part of LIBERTY
19 MUTUAL and on the part of CONTINENTAL with regard to the manner in which
20 they treat their insureds.

21 53. KELLY-MOORE is informed and believes and thereon alleges that in
22 taking such actions, LIBERTY MUTUAL and CONTINENTAL each acted with malice,
23 fraud and/or oppression, as defined as California Civil Code §3294.

24 54. As a proximate result of LIBERTY MUTUAL's and CONTINENTAL's
25 actions, KELLY-MOORE has been caused to suffer and will continue to suffer
26 substantial prejudice and damages.

55. As a further proximate result of LIBERTY MUTUAL's and CONTINENTAL's actions, KELLY-MOORE has incurred, and will continue to incur, attorneys' fees and related costs in order to obtain the policy benefits LIBERTY MUTUAL and CONTINENTAL have withheld.

56. As a result of LIBERTY MUTUAL's and CONTINENTAL's conduct, as alleged herein, KELLY-MOORE is entitled to recover its damages, including attorneys' fees and expenses, and to claim and recover punitive damages from LIBERTY MUTUAL and CONTINENTAL, in amounts sufficient to punish and make an example of LIBERTY MUTUAL and CONTINENTAL in order to deter such conduct in the future.

WHEREFORE, plaintiff prays judgment against defendants LIBERTY MUTUAL and CONTINENTAL, as hereinafter set forth.

THIRD CAUSE OF ACTION

(Declaratory Relief Against All Defendants)

57. Plaintiff incorporates by reference paragraphs 1 through 56 and realleges said allegations as though here fully set forth.

58. Each of the excess liability policies listed in Exhibits A and B provided defense and indemnity coverage to KELLY-MOORE for bodily injury claims, including asbestos-related personal injury claims that comprise the Asbestos Litigation.

59. Claimants in the Asbestos Litigation allege bodily injury that occurred during the time period that each of defendants' excess liability policies was in effect.

60. KELLY-MOORE is informed and believes, and thereon alleges, that based upon preliminary projections of its asbestos-related liabilities arising out of the Asbestos Litigation, the bodily injury products aggregate limits of each of the defendants' excess liability policies will be exhausted or impacted in the near future.

61. An actual controversy of a justiciable nature exists between KELLY-MOORE and defendants over defendants' rights, duties and obligations arising out of the terms, conditions, exclusions and limitations of defendants' respective liability insurance policies regarding the Asbestos Litigation.

62. KELLY-MOORE desires and is entitled to a judicial declaration of the rights, duties and obligations of defendants setting forth the extent of the duty to defend and/or indemnify that defendants owe to KELLY-MOORE under defendants' respective liability insurance policies in the Asbestos Litigation.

WHEREFORE, plaintiff prays for judgment against defendants as follows:

1. For special damages against LIBERTY MUTUAL and CONTINENTAL according to proof;

2. For exemplary damages against LIBERTY MUTUAL and CONTINENTAL according to proof;

3. For declaratory relief against all defendants that each defendant owes a duty to defend and indemnify plaintiff under their respective policies of excess liability insurance relating to the Asbestos Litigation;

4. For attorneys' fees incurred in obtaining policy benefits;

5. For costs of suit incurred herein;

6. For prejudgment interest; and

7. For such other and further relief that the court may deem just and proper.

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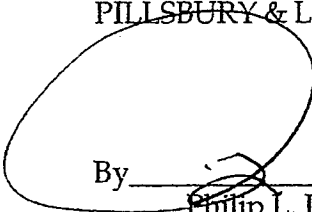
JURY DEMAND

Plaintiff KELLY-MOORE PAINT COMPANY, INC. demands trial by jury.

Dated: October 4, 2001

PILLSBURY & LEVINSON, LLP

By


Philip L. Pillsbury, Jr.

Attorneys for Plaintiff
KELLY-MOORE PAINT COMPANY, INC.

EXHIBIT A

*Kelly-Moore Paint Company, Inc. v.
Liberty Mutual Insurance Company, et al.*

EXHIBIT A (First Excess Layer) TO:

COMPLAINT FOR BREACH OF CONTRACT, BREACH OF THE COVENANT OF
GOOD FAITH AND FAIR DEALING, AND DECLARATORY RELIEF; DEMAND
FOR JURY TRIAL

INSURANCE CARRIER	POLICY NUMBER	POLICY TERM
Continental Casualty Company	RDX9686114	1/1/64-1/1/65
Insurance Company of North America, Inc.	XBC5650	1/1/65-1/1/69 (4 annual periods)
Insurance Company of North America, Inc.	XBC22366	1/1/69-1/1/72 (3 annual periods)
American Home Assurance Company	BE2674274	12/1/70-1/1/74 (4 annual periods)
North River Insurance Company	DCL917362	10/26/71-12/17/71
North River Insurance Company	DCL917542	12/17/71-1/1/75 (4 annual periods)
Liberty Mutual Insurance Company	LG1-161015355-054	1/1/74-5/1/74
Liberty Mutual Insurance Company	LG1-161015355-104	5/1/74-5/1/75
Liberty Mutual Insurance Company	LG1-161015355-105	5/1/75-5/1/76
Liberty Mutual Insurance Company	LG1-161015355-106	5/1/76-5/1/77
Liberty Mutual Insurance Company	LG1-161015355-107	5/1/77-5/1/78
Liberty Mutual Insurance Company	LG1-161015355-108	5/1/78-5/22/78
Mission Insurance Company	M849015	5/1/79-5/1/80
Continental Insurance Company	SRU2155623	5/1/80-5/1/81
Continental Insurance Company	SRU2155665	5/1/81-5/1/82
Continental Insurance Company	SRU2155750	5/1/82-10/1/83 (2 annual periods)

**Kelly-Moore Paint Company, Inc. v.
Liberty Mutual Insurance Company, et al.**

EXHIBIT B (Second & Third Excess Layers) TO:

**COMPLAINT FOR BREACH OF CONTRACT, BREACH OF THE COVENANT OF
GOOD FAITH AND FAIR DEALING, AND DECLARATORY RELIEF; DEMAND
FOR JURY TRIAL**

INSURANCE CARRIER	POLICY NUMBER	POLICY TERM
Federal Insurance Company	7920443	6/24/77-5/1/78
United States Fire Insurance Company	522-0001692	5/1/78-5/23/78
First State Insurance Company	926755	6/5/78-5/1/79
Interstate Fire & Casualty Company	155-U027331	6/5/78-5-1-79
Continental Casualty Company	RDX1787608	5/1/80-5/1/81
Continental Casualty Company	RDX1776773	5/1/81-5/1/82
Continental Casualty Company	RDX1776851	5/1/82-10/1/83 (2 annual periods)
Continental Casualty Company	RDX62135809	10/1/83-2/14/84
Integrity Insurance Company	XL208293	2/14/84-10/1/84
Insurance Company of North America	XPC156102	2/14/84-10/1/84
Transport Indemnity Company	TEL00810C	2/14/84-10/1/84
First State Insurance Company	925027	6/24/77-5/1/78
Federal Insurance Company	79227956	5/1/78-523/
American Excess Insurance Company	EUL5073250	5/1/80-5/1/81

EXHIBIT 38

STEPHEN FERRARI

March 26, 2008

Page 1

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO AND OAKLAND DIVISION

THOMAS FERNANDEZ, et al.,)	
)	
Plaintiffs,)	
)	Case No.
vs.)	
)	C-06-07339 CW
K-M INDUSTRIES HOLDING CO., INC., et al.,)	
)	
Defendants.)	
)	
)	
)	

VIDEOTAPED DEPOSITION OF STEPHEN FERRARI
March 26, 2008
Oakland, California

Reported by:
EMI ALBRIGHT
RPR, CSR No. 13042
Job No. 79126

STEPHEN FERRARI

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1 BY MR. JACKSON:

2 Q We have taken a short break. Are you ready
3 to continue, Mr. Ferrari?

4 A Yes.

10:37 5 Q Thank you. How did the idea of setting up
6 the ESOP come about?

7 A I recall Bill Moore became aware of the
8 ESOP and decided to investigate, investigate an ESOP a
9 little bit further.

10:38 10 Q I see. And when you say Bill Moore became
11 aware of the ESOP -- and by Bill Moore you also referred
12 to him as Mr. Moore quite often?

13 A Bill Moore and Mr. Moore.

14 Q So Bill Moore became aware of an ESOP.
10:38 15 What do you mean by that?

16 A Well, he became aware that ESOPs existed.
17 And he I believe got the understanding that with an ESOP
18 one could get some -- an owner of a company could get
19 some liquidity of a company. He also could provide an
10:38 20 retirement plan for individuals, provide them with an
21 ownership interest in a company. And the ESOP also
22 would provide for certain tax deductions. And when he
23 became aware of all these benefits of an ESOP, he
24 decided that it would be appropriate to look into the
10:39 25 possibility of an ESOP further.

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1 Q Other than relying on Cheryl Mills, what
2 other steps, if any, did the company take to address its
3 concerns about asbestos related lawsuits?

4 MR. PALMER: Object to the form.

13:56 5 A I don't recall right now. In 1998 we did
6 rely on our counsel and I believe Cheryl Mills did
7 extensive analyses of the coverage. And again it was my
8 understanding that's who the company relied upon. Joe
9 Cristiano was the main person who dealt with her.

13:57 10 BY MR. JACKSON:

11 Q When you said it's your understanding that
12 she did extensive analysis, did you talk to her about
13 the analysis she did?

14 A I believe Joe Cristiano was the main person
13:57 15 that talked with her. I believe I may have had
16 conversations with her on occasion, though. I don't
17 recall the detail of those conversations at the moment.

18 Q Do you recall what she told you she was
19 doing as her analysis?

13:57 20 A I don't recall the details of that right
21 now.

22 Q Do you recall if she hired an actuary to
23 take a look at the number of asbestos lawsuits that
24 could be filed?

13:57 25 A I don't recall.

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1 officially whether Cheryl Mills still felt that way.

2 I believe this was near the time of the

3 transaction -- the ESOP transaction. So we, Joe

4 Cristiano and I, called her up and asked her is that

14:13 5 still the case that the insurance still will cover any

6 and all asbestos claims. And she basically said that

7 was the case. And we wrote that down. And I put that

8 in the file, I believe.

9 I believe after that Cheryl Mills continued

14:14 10 to represent in 1998, that that was the case. And

11 simply as part of our due diligence to do what's right

12 in the interest of the participants and in the interest

13 of setting up the ESOP, I wanted to know or we wanted to

14 know. And that's why we had that conversation.

14:14 15 Q Did you tell Mr. Moore about your

16 conversation with Cheryl Mills?

17 A I don't recall.

18 Q Did you tell the ESOP participants about

19 your conversation with Cheryl Mills?

14:15 20 A I don't believe there was any specific

21 conversation with the ESOP participants because there

22 was not a concern. Basically we got the representation

23 that the asbestos claims were covered by insurance. I

24 know where that especially changed was after the

14:15 25 Hernandez lawsuit. At that time I recall specifically

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1 Q Other than letters to auditors, were there
2 any other letters from Cheryl Mills that you are aware
3 of addressing insurance coverage in the asbestos
4 litigation prior to December 11th 1998?

15:17 5 MR. PALMER: Object to the form.

6 A There may have been. I don't recall right
7 now.

8 BY MR. JACKSON:

9 Q So you don't know if there were or not?

15:17 10 A I don't recall.

11 Q If I represent to you -- well, where would
12 such documents be stored?

13 A Normally they were kept in the files behind
14 Arleen Lombardi's desk at Kelly-Moore Paint Company.

15:17 15 Q I am going to ask you to take a look at a
16 document which we will mark as 76.

17 (Exhibit No. 76 marked
18 for identification.)
19

15:18 20 Q It's KMH 7204 and 05.

21 MR. LOVITT: Is there an extra copy over
22 there? Okay.

23 BY MR. JACKSON:

24 Q Is this the letter you were referring to a
15:18 25 moment ago when you said that there were documents sent

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1 by Cheryl Mills to the auditor?

2 A I believe this was the letter. I don't see
3 any carbon copy from Kelly-Moore, but I believe
4 Kelly-Moore did get a copy of this letter. Typically
15:19 5 the letters that went to auditors normally were copied
6 Kelly-Moore.

7 Q So this is the earlier letter you were
8 referring to?

9 A I believe this was the letter.

15:19 10 Q Other than Exhibit 76 and the letter in
11 Exhibit 75, prior to December 11th of 1998, do you
12 recall if there were any other letters regarding
13 insurance coverage in the asbestos litigation from
14 Cheryl Mills?

15:19 15 A There may have been other letters in 1998.
16 I don't recall. There may have been other letters in
17 conjunction with prior audits that were similar to this.
18 I don't recall the details right now.

15:20 19 Q Other than letters to auditors, do you
20 recall prior to December 12th 1990 -- I'm sorry --
21 December 11th 1998, there being any letter from Cheryl
22 Mills to anyone at the company that you saw that laid
23 out insurance coverage for asbestos litigation?

15:20 24 A There may have been but I just don't recall
25 right now.

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1 any discussions with anyone at the company about this
2 December 11th 1998, letter from Cheryl Mills?

3 A I don't know. I don't recall right now.

4 Q Do you recall disclosing it to Mr. Moore?

15:32 5 A I don't recall.

6 Q Do you recall disclosing it to the ESOP
7 participants?

8 A I don't recall disclosing it to the ESOP
9 participants because it says there was adequate
15:32 10 insurance to -- adequate insurance to cover asbestos
11 litigation and future asbestos litigation. It wasn't
12 until after the Hernandez case I believe that there was
13 more concerns about what was happening with the asbestos
14 litigation. And since we wanted to do what was right
15:32 15 for the participants, we disclosed information when the
16 company had concerns. As we got information that there
17 was concerns based upon the discussions with our
18 attorneys, we disclosed information to the ESOP
19 participants.

15:33 20 Q Let's go back to that letter for a second
21 then on Exhibit 75. On the first page of it, so
22 Exhibit 75, what is the second page and the first page
23 of the letter; do you see that page?

24 A Yes.

15:34 25 Q The sentence beginning, as we both know; do

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1 Q Tell me when you've had a chance to look at
2 that.

3 A I see this letter.

4 Q I am going to ask you to go back to 75 for
15:37 5 a moment. Do you have Exhibit 75 in front of you?

6 A I do have Exhibit 75.

7 Q Did you give Exhibit 75 to B.J. Brooks?

8 A I don't recall.

9 Q Do you know if Mr. Cristiano did?

10 15:38 A I don't recall.

11 Q Do you know if anybody at Paint did?

12 A I don't recall.

13 Q Did you give it to Mr. Ireland?

14 A I don't recall.

15 15:38 Q Do you --

16 A I recall that we discussed asbestos
17 litigation and insurance coverage with Mr. Brooks and
18 Mr. Ireland, but I don't recall specifically what
19 documents we gave to them.

20 15:38 Q Did you give them this letter; do you know?

21 A I don't know.

22 Q This letter wasn't received until after the
23 initial Paint transaction; correct?

24 A I believe the ESOP transaction for
15:39 25 Kelly-Moore Paint was 1998. And this letter appears to

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1 MR. PALMER: Object to the form.

2 MS. DILLER: Argumentative.

3 A I gave him whatever information that he
4 requested. I also told him about any -- told him about
16:31 5 asbestos litigation and insurance coverage. If he would
6 have asked me for any information, I would have given it
7 to him. I am not sure what he asked for and what I gave
8 him.

9 BY MR. JACKSON:

16:31 10 Q What exactly did you tell him about
11 asbestos litigation?

12 A I don't recall the detail of that
13 conversation right now. I know that based upon the
14 information we had gotten from Cheryl Mills is that we
16:32 15 had a large number of asbestos claims and that I also
16 told him that based upon the information that we got
17 from her, she said that we had plenty of insurance right
18 now.

19 Q Anything else you told him?

16:32 20 A I don't recall right now.

21 Q Do you know why he didn't mention any of
22 that information in his reports?

23 MR. PALMER: Object to the form. Calls
24 for speculation.

16:32 25 BY MR. JACKSON:

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1 Q Asking if you know?

2 A I don't know.

3 Q Did you tell him that there were over
4 10,000 claims at the time that the valuation was done?

16:32 5 A I don't recall if I told him an exact
6 number. But I do recall that I told him that there was
7 many claims so that he knew that there was a large
8 magnitude of asbestos litigation.

9 Q Did you give him any document which laid
16:33 10 out the magnitude of the asbestos litigation?

11 A I don't recall.

12 Q Do you know if he took notes when you told
13 him this?

14 A I don't specifically recall.

16:33 15 Q Do you generally recall whether or not he
16 was taking notes when you met with him about the
17 company?

18 A I don't recall.

19 Q I am going to ask you to take a look at
16:33 20 what has been previously marked as Exhibit 52.
21 Actually, let's start with Exhibit 53. You already have
22 53?

23 A I have 53 here.

24 Q I will ask you to look at the second page
16:34 25 there. Do you have that document in front of you?

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1 update letter.

2 A There is 55 and here is Exhibit 9.

3 Q Looking first at Exhibit 9, did you review
4 a draft of this document before you reviewed the final
17:06 5 document?

6 A I don't recall if I reviewed a draft before
7 the final document, if there was one. I don't recall.

8 Q Do you recall receiving what you understood
9 to be a draft and writing anything on a draft?

17:07 10 A I don't recall.

11 Q What about Exhibit 55? Do you recall if
12 you ever saw a draft of 55 before it became final?

13 A I don't recall.

14 Q All right. I am going to ask you to
17:07 15 look -- oh, William Moore made the final decision about
16 what the transaction price for the October 1998 Paint
17 ESOP would be; correct?

18 A We received -- we received a valuation from
19 Mr. Brooks, and that provided -- it was an independent
17:07 20 appraisal from Mr. Brooks. And that provided the basis
21 for the ESOP transaction in October of 1998.

22 Q When you said we received, what do you mean
23 by we?

24 A Well, it came to the company.

17:08 25 Q Were you a part of the decision to accept

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1 that as a reasonable value and use it as the transaction
2 price for the 1998 ESOP?

3 A I recall that William E. Moore made the
4 final decision as to accepting the valuation. I recall
17:08 5 it was discussed with Joe Cristiano and myself. I don't
6 recall the details of that discussion right now, but I
7 seem to recall that.

8 Q When did that discussion happen?

9 A I don't recall.

17:08 10 Q Did it happen before the transaction?

11 A I just don't recall the date of the
12 transaction -- I mean, the date of that discussion.

13 Q And do you recall anything that Mr. Moore
14 said about why he was accepting the Brooks report?

17:08 15 A I don't recall the details of that
16 discussion. We went to Mr. Brooks to give us an
17 independent valuation. I gave him all the information
18 he needed and he provided that information. We looked
19 at it to see if we saw anything that was unreasonable
17:09 20 and then simply went with the valuation, I believe.

21 Q And my question is do you recall anything
22 Mr. Moore said about why he was accepting the Brooks
23 report?

24 A I don't recall any of those details right
17:09 25 now.

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1 Q Did you have a meeting -- you said there
2 was a meeting with him and Mr. Cristiano; is that right?

3 A I don't recall if I said there was a
4 meeting. I believe I said that there was a discussion
17:09 5 with Mr. Moore and Mr. Cristiano regarding the
6 valuation.

7 Q Was that a face to face meeting or
8 discussion?

9 A I just don't recall right now.

17:09 10 Q Was that discussion at Mr. Moore's house;
11 do you recall?

12 A I don't recall.

13 Q And do you recall what Mr. Moore said, if
14 anything, about the valuation and why he was going to
17:10 15 use it to set the price for the ESOP?

16 A I don't recall --

17 MS. DILLER: Mischaracterizes testimony.
18 Object to the form.

19 A I don't recall the details right now.

17:10 20 BY MR. JACKSON:

21 Q Do you recall if there were any
22 negotiations about the transaction price for the ESOP?

23 MR. PALMER: Object to the form.

24 A Mr. Brooks was -- was -- was engaged to
17:10 25 provide a valuation. I don't recall negotiations with a

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1 valuation. That wouldn't seem appropriate.

2 BY MR. JACKSON:

3 Q Do you recall any negotiations between the
4 buyer and -- the seller of the shares, the Moore Trust
17:10 5 and the buyer of the shares, the ESOP, regarding the
6 price that the transaction would be done at?

7 MR. PALMER: Object to the form.

8 A I don't recall any such details.

9 BY MR. JACKSON:

17:11 10 Q Do you recall if there were any
11 negotiations?

12 A I don't recall.

13 Q Were you a party to any such negotiations?

14 A I don't recall.

17:11 15 Q Well, would you recall if there were
16 actually negotiations where you said, I think the price
17 should be higher or lower for the ESOP deal?

18 A I don't recall.

19 Q Would you recall if there were any
17:11 20 discussions that you were involved in where the amount
21 of the ESOP deal was discussed?

22 A I recall there was discussions that I had
23 with Joe Cristiano and William Moore regarding the
24 valuation that Mr. Brooks provided. I don't recall
17:11 25 further detail of discussions at the present time.

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1 Q And do you recall if there was any point at
2 which there was a negotiation about what the price
3 should be?

4 MR. PALMER: Object to the form. You
17:12 5 asked him that. He's answered it several times.

6 A I don't recall any such negotiations with
7 Mr. Brooks. I don't believe anything like that
8 occurred. I don't recall a further details of
9 discussions.

17:12 10 BY MR. JACKSON:

11 Q Do you recall any negotiations between
12 Mr. Moore and anybody else regarding what the price for
13 the ESOP should be?

14 A I don't recall.

17:12 15 Q Do you recall any conversations or
16 negotiations between Mr. Cristiano and anyone else
17 regarding what the price for the ESOP's sales should be?

18 A I don't recall.

19 Q Were you a party to any conversations where
17:12 20 you negotiated with anyone regarding what the price of
21 the ESOP shares should be?

22 A I don't recall.

23 MR. LOVITT: What is the time check,
24 please, Mr. Video Man?

17:13 25 MR. JACKSON: We can go off the record to

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1 Q To your knowledge is this the first time
2 that the company informed employees regarding the
3 asbestos litigation liabilities for Kelly-Moore Paint?

4 MS. DILLER: Object to the form.

17:47 5 MR. PALMER: Object to the form.

6 A I don't recall if this was the first time
7 that employees were aware of asbestos litigation.

8 BY MR. JACKSON:

9 Q I didn't ask whether they were aware. I
17:47 10 said that the company informed them.

11 MS. DILLER: Object to the form.

12 A I don't recall if this is the first time
13 that the employees were informed of asbestos litigation.
14 I believe it was common knowledge that there was some
17:48 15 asbestos litigation there. I don't recall which Mind
16 Your -- Our Own Business was the first time that it was
17 mentioned right now. I know in various Mind Our Own
18 Businesses asbestos litigation was mentioned. This was
19 first time that the Hernandez -- this was the Hernandez
17:48 20 case. And I believe that was the first time it was
21 mentioned.

22 BY MR. JACKSON:

23 Q My question is do you think that you told
24 the employees in a Mind Our Own Business prior to
17:48 25 October of 2001 that there was asbestos liability at the

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1 company?

2 A I don't recall.

3 Q And you said that you thought it was common
4 knowledge. What is your basis for that?

17:49 5 A Some of the employees who worked at
6 Kelly-Moore had been there since there was asbestos
7 relating -- there was products that contained asbestos.
8 I believe they had worked there a long time and were
9 aware that the asbestos was in products made by PACO
17:49 10 Textures Corporation, which I believe were made -- some
11 may have been made on premises of Kelly-Moore Paint
12 Company. And since those employees had worked there a
13 long time, I believe they were aware of some of the
14 lawsuits.

17:49 15 MR. PALMER: Do you have a time check?

16 BY MR. JACKSON:

17 Q Other than those --

18 THE VIDEOGRAPHER: One minute and ten
19 seconds.

17:49 20 BY MR. JACKSON:

21 Q Other than those employees, any other basis
22 you have for saying that there was knowledge about the
23 asbestos liability?

24 A I don't recall details on that right now.

17:50 25 Q Did you have any direct discussions with

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1 employees about asbestos liability?

2 MR. PALMER: Object to the form.

3 MS. DILLER: Object to the form.

4 A I don't recall.

17:50 5 BY MR. JACKSON:

6 Q And going back to Mr. Ireland's valuations,
7 for the valuations after 1998, do you recall any
8 questions that anyone at Kelly-Moore had about any of
9 those valuations?

17:50 10 MR. PALMER: Object to the form.

11 MS. DILLER: Can you repeat the question?

12 MR. LOVITT: Would you please reread the
13 question back.

14 BY MR. JACKSON:

17:50 15 Q For valuations, Mr. Ireland's valuations
16 after the valuation for the year ending 1998, do you
17 recall any questions that anyone at Kelly-Moore had
18 about any of those valuations?

19 MR. PALMER: Object to the form.

17:50 20 A I don't recall.

21 BY MR. JACKSON:

22 Q So you don't recall any questions?

23 MR. PALMER: Object to the form.

24 MS. DILLER: Object to the form.

17:50 25 Mischaracterizes testimony.

EXHIBIT 39

CONFIDENTIAL

**MINUTES OF ANNUAL COMBINED MEETING OF THE
BOARD OF DIRECTORS AND SHAREHOLDERS
OF
KELLY-MOORE PAINT COMPANY, INC.**

APRIL 21, 1998

REDACTED

KMH 000452

CONFIDENTIAL

REDACTED

KMH 000453

CONFIDENTIAL

REDACTED

KMH 000454

CONFIDENTIAL

REDACTED

KMH 000455

CONFIDENTIAL

REDACTED

KMH 000456

EXHIBIT 40

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO AND OAKLAND DIVISION

THOMAS FERNANDEZ, et al.,
Plaintiffs,

vs.

K-M INDUSTRIES HOLDING CO., INC., et al.,
Defendants.

)
)
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) Case No.
)
) C-06-07339 CW
)
)
)
)
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)

VIDEOTAPED DEPOSITION OF JOHN MENKE
March 21, 2008
Oakland, California

Reported by:
EMI ALBRIGHT
RPR, CSR No. 13042
Job No. 79125

1 called Menke & Associates, comma, Inc., dash, Georgia.

2 Q And that is still in existence?

3 A Yes.

4 Q Does it have any employees?

5 A No.

6 Q And no asset?

7 A No. And then we have another one that is
8 Menke & Associates, comma, Inc., dash, Illinois.

9 Q Any others?

10 A No.

11 Q Did Menke & Associates, Inc. Georgia or
12 Menke & Associates, Inc. Illinois, did either of them
13 have anything to do with the Kelly-Moore ESOP or play
14 any role in the Kelly-Moore ESOP?

15 A No.

16 Q All right. Starting with Menke &
17 Associates, is Menke & Associates, Inc. a wholly owned
18 subsidiary of the Menke Group?

19 A Yes.

20 Q What services does Menke & Associates
21 provide?

22 A Menke & Associates provides plan
23 installation services, provides employee communication
24 services, and provides annual administration, slash,
25 recordkeeping services, and provides legal services.

1 Q When you say that it provides these
2 services, these are all in the context of ESOPs;
3 correct?

4 A Correct.

5 Q Is there does Menke & Associates provide
6 non-ESOP related plan installation, employee
7 communications, plan administration, or legal services?

8 A We provide some non-ESOP services, limited
9 services for clients who also have a 401(k) or a profit
10 sharing plan or a money purchase plan. And we also
11 provide, back in your prior question, in addition to
12 services, there is some limited investment banking
13 services.

14 Q What investment banking services does Menke
15 & Associates provide?

16 A Feasibility studies and assisting in
17 raising financing for ESOP transactions.

18 Q When you say feasibility studies, what do
19 you mean?

20 A These are Excel feasibility studies as to
21 whether a particular transaction involving an ESOP might
22 or might not be feasible.

23 Q And when you say Excel, do you mean that
24 they are Excel spreadsheets involved?

25 A Excel spreadsheets, yes.

1 Q And typically what information is included
2 in a feasibility study as to whether or not an ESOP will
3 make sense?

4 A Well, one item would be whether the
5 transaction will be financeable, whether it will meet
6 the cash flow test, cash flow requirements and meet --
7 have enough coverage ratio, for example, so that it
8 would be appealing or attractive to a lender. And then
9 the other issue is typically whether the company's
10 eligible payroll is large enough to accomplish the
11 transaction within contribution limits and allocation
12 limits.

13 Q And when you say the eligible payroll is
14 large enough to meet allocation and contribution limits,
15 you mean in order to get the plan tax qualified; is that
16 correct?

17 A In order for the transaction to fit.

18 Q To fit what?

19 A To fit within those limitations.

20 Q If you can explain to me your understanding
21 of contribution limits?

22 A Well, in an ESOP the basic limit is that
23 contributions in the case of a regular "C" corporation
24 are limited to 25 percent of payroll plus interest. If
25 the one third rule is passed, you can contribute -- the

1 company sponsor can contribute in addition to that
2 25 percent interest on the ESOP loan and in addition to
3 that under 404 can contribute deductible dividends, if
4 the dividends are used to pay down the ESOP loan.

5 Q When you say refer to 404, what are you
6 referring to?

7 A Of the Internal Revenue Code.

8 Q So Section 404; is that correct?

9 A Section 404.

10 Q And when you say allocation limits, what
11 are you referring to?

12 A I am referring to Section 415 of the Code.

13 Q And particularly what about 415?

14 A Well, 415 currently limits allocations to
15 any one individual to the lesser of 45,000 or
16 100 percent of compensation.

17 Q You said the other investment advice that
18 Menke & Associates may provide is financing. What do
19 you mean by that?

20 A Well, assisting the company in raising the
21 financing for an ESOP transaction.

22 Q And what sort of financing assistance does
23 Menke & Associates provide to clients when they ask for
24 it?

25 A That would typically involve preparation of

1 a deal book, which explains the company, the
2 transaction, and has the financial models. So we would
3 assist them in preparing a deal book or what you might
4 call an offering memorandum. And then assist them with
5 soliciting indications of interest from banks or other
6 lenders and then assisting in negotiating the terms of
7 the loan.

8 Q How is Menke typically -- how is Menke &
9 Associates typically compensated for providing this
10 financing?

11 MR. PALMER: Object to form.

12 THE WITNESS: Sorry?

13 MR. PALMER: I object to the form of the
14 question.

15 THE WITNESS: Okay. Well, I think that's
16 fairly clear that we would typically charge a fee for
17 the preparation of the deal book and then a fee for -- a
18 success fee for raising the financing, contingent upon
19 the success of the transaction.

20 BY MR. JACKSON:

21 Q Is that success fee sometimes tied to
22 whether or not you save the client money regarding the
23 interest rate of a loan, for instance?

24 A Yes.

25 Q And is that success fee sometimes tied to

1 you get a percentage of the amount that you are deemed
2 to have saved the client?

3 A Correct.

4 Q You mentioned plan installation -- bless
5 you -- as one of the services that Menke & Associates
6 provides. What are the constituent elements of plan
7 installation services that Menke & Associates provides?

8 A Yes, those are spelled out in our proposal
9 for plan installation, consist of financial consulting
10 about the feasibility of the transaction. It includes
11 drafting the plan trust and related documents. Includes
12 procuring the IRS determination letter. It includes
13 giving the initial employee meeting or meetings
14 explaining the plan. And it includes providing them
15 with administrative forms to administer and operate the
16 plan.

17 Q And the legal services, it sounds like
18 you've just covered the employee communication,
19 administration, and plan installation functions. What
20 about the legal services function? What --

21 A The legal services are optional services.

22 Q And typically what would those optional
23 services that Menke & Associates offers be?

24 A Those would be --

25 MR. PALMER: Object to the form.

1 A Those would be spelled out in our optional
2 services agreement. It's attached to our installation
3 proposal. And it would include drafting the ESOP
4 transaction documents, which would include the stock
5 purchase agreement, the ESOP loan agreement, the ESOP
6 promissory note, the ESOP pledge agreement. And then in
7 addition we also provide drafts or documents, legal
8 documents for various employee incentive plans such as
9 management stock bonus plans or a stock option plan or a
10 SERP, Supplemental Executive Retirement Plan, or phantom
11 stock plan.

12 BY MR. JACKSON:

13 Q Does Menke & Associates also provide
14 selling shareholders advice as to investment vehicles
15 for the proceeds of a sale to an ESOP?

16 A I'm sorry. Repeat that.

17 Q Does Menke & Associates also provide
18 selling shareholders advice as to the investment
19 vehicles they can use for the proceeds of a sale to an
20 ESOP, a sale of company stock to an ESOP?

21 A No.

22 Q That service has been provided to some
23 Menke Group clients in the past; is that correct?

24 MR. OTIS: Excuse me. Could you read the
25 question back, please? The question before that?

1 Mark Bowers. And then everybody else is involved in
2 recordkeeping and administration.

3 Q Sansome Street Appraisers is a wholly owned
4 subsidiary of Menke Group?

5 A Right.

6 Q What services does Sansome Street
7 Appraisers provide its clients?

8 A Appraisals and fairness opinions.

9 Q All in the ESOP context?

10 A Yes.

11 Q Does Sansome Street Appraisers provide
12 appraisals and fairness opinions for ESOPs that are not
13 being installed by Menke & Associates?

14 MR. PALMER: Object to the form.

15 A Does it provide appraisal services and
16 fairness opinions that are not installed by -- basically
17 not. Now, there is some plans that we don't install but
18 later we come to administer. And then they would be a
19 Menke client, and they might be a case or two where then
20 Sansome Street does services for a plan that we didn't
21 install.

22 BY MR. JACKSON:

23 Q Who heads Sansome Street Appraisers?

24 A I do.

25 Q Are you a CEO or do you have another title,

1 if you know?

2 A Just I use president.

3 Q And does Sansome Street Appraisers have
4 employees?

5 A No.

6 Q Does it have independent contractors that
7 it uses to do appraisals?

8 A Yes.

9 Q And how many?

10 MR. PALMER: Object to the form.

11 A We have 10 to 15.

12 BY MR. JACKSON:

13 Q Okay. Do those appraisers work only for
14 Sansome Street Appraisers or do they work for other
15 clients as well?

16 A They work for other clients as well.

17 Q Are there any subdivisions or subsidiaries
18 of Sansome Street Appraisers?

19 A No.

20 Q Can you tell me from 1998 to present if any
21 Sansome Street Appraisers were involved in the
22 Kelly-Moore Holding ESOP?

23 A Yes.

24 Q And who were those appraisers?

25 A Jack Brooks and Bob Ireland.

1 Q And does Jack Brooks also go by B.J.
2 Brooks?

3 A B.J. Brooks, yes. And Bob Ireland is
4 Robert M. Ireland. Robert M -- is that right? Okay.

5 Q And were there any other Sansome Street
6 Appraisers who provided any appraisal services to
7 Kelly-Moore with regard to its ESOP?

8 MS. DILLER: Object to the form.
9 BY MR. JACKSON:

10 Q Fair enough. Kelly-Moore Holding with
11 regard to its ESOPs?

12 A Not that I know of.

13 Q Did Global Telecommunications Investment
14 Group, LLC have anything to do with the Kelly-Moore
15 Holding ESOP?

16 A No, no.

17 Q For the legal department at Menke &
18 Associates, does the legal department ever contract with
19 outside counsel to provide particular legal services?

20 MR. PALMER: Object to the form.

21 A Yeah, I'm not sure what you mean by does it
22 ever contract. I mean, the legal --

23 BY MR. JACKSON:

24 Q Let me put it in simpler terms. Does Menke
25 & Associates -- does the Menke & Associates legal

1 Q Do you remember what was talked about at
2 that meeting?

3 A I don't remember very much of what was
4 talked about. I think Mr. Moore had a number of
5 questions of which leads me to believe that he had not
6 yet made a final decision.

7 The one thing I remember about the meeting
8 was that we -- I mentioned how growing up as a kid in
9 Amarillo, I had even seen Kelly-Moore stores. And then
10 he mentioned how that was one of his favorite stores was
11 the one in Amarillo because he bought that store, bought
12 that property years ago, and it was on the old Route 66
13 which used to be the old Chisholm Trail. And he sort of
14 went off, you know, in fond memories of the good old
15 days.

16 Q Other than telling you about the Amarillo
17 store, did he tell you why he was considering creating
18 an ESOP?

19 A I don't -- I don't remember that
20 discussion, no.

21 Q At some point you came to understand that
22 he was considering establishing an ESOP among other
23 reasons to cash out some of his value in the company on
24 a tax advantage basis; right?

25 A Right.

1 been in the file. But I don't recall seeing this cover
2 letter.

3 Q When you say the proposal, what are you
4 referring to?

5 A The installation proposal.

6 Q Okay. Looking at the second page of that
7 document, under confidentiality preserved each year,
8 salaries, bonuses, ownership perks are not disclosed,
9 under that heading?

10 A Correct.

11 Q Was it typical for the marketer to tell
12 clients that the employees don't have to see balance
13 sheets or profit loss statements or even the appraisal?

14 A I don't know whether it's typical for all
15 of them or not. This was Kyle's sort of standard
16 letter.

17 Q And do you recall talking to Mr. Moore
18 about the fact that the employees don't have to see
19 balance sheets or profit and loss statement or even
20 appraisals if you set up an ESOP?

21 A I don't recall.

22 Q Do you recall Mr. Coltman telling you that
23 he talked to Bill Moore about that?

24 A No.

25 Q Do you recall if at any point in your

1 discussions with Bill Moore he said it was important to
2 him that he be able to keep certain information
3 confidential?

4 A I don't remember a specific conversation
5 about that.

6 Q Do you remember a general statement by him
7 about that or --

8 A I can just vaguely remember, you know, a
9 general conversation or, you know, concern about keeping
10 control. And almost every owner has a question, you
11 know, or two about that, am I really going to be able to
12 keep control.

13 Q And by keep control, what do you mean?

14 A Keeping the voting control.

15 Q Okay. And are there any other aspects to
16 keeping control other than just having voting control?

17 MR. PALMER: Object to the form.

18 MR. OTIS: Would you read that question
19 back, please?

20 BY MR. JACKSON:

21 Q I can read it. Are there any other aspects
22 to keeping control other than having voting control?

23 MR. PALMER: Object to the form.

24 MS. DILLER: Calls for expert testimony.

25 BY MR. JACKSON:

1 Q In your knowledge?

2 A I'm sorry. What?

3 Q In your knowledge?

4 MR. OTIS: Do you understand the question?

5 A Are there any aspects to control that --

6 what?

7 BY MR. JACKSON:

8 Q Actually let me break it out. You said
9 keeping voting control. Let's start with that. What
10 was Mr. Moore's concern about keeping voting control?

11 MS. DILLER: Mischaracterizes testimony.
12 Assumes facts not in evidence.

13 A Yeah, that --

14 BY MR. JACKSON:

15 Q What did Mr. Moore tell you about his
16 desire to keep voting control?

17 A Well, mainly he wanted to absolutely
18 maintain control.

19 Q And absolutely maintain voting control?

20 A Voting control.

21 Q Was there any other type of control that
22 you discussed with Mr. Moore?

23 A And I don't -- that I don't specifically
24 recall.

25 Q And did you explain to him how he could

1 keep absolute control of voting?

2 A Yeah, simply by being the committee and the
3 trustee.

4 Q I see. And as the trustee he would vote
5 the ESOP shares; correct?

6 A Correct.

7 Q And, in fact, under the control heading
8 here, Mr. Coltman's letter says, you may elect yourself
9 to be a one person ESOP committee, thereby voting all
10 the stock in the ESOP for as long as you wish; correct?

11 A Uh-huh.

12 Q And, in fact, Mr. Moore did decide to elect
13 himself as a one person ESOP committee, didn't he?

14 A I believe so.

15 Q You said prior to the meeting you would
16 have taken a look at the file; is that correct?

17 A Well, whatever I had. I mean, if -- so at
18 that point I don't know if he had signed the proposal or
19 just had a proposal. But I think I would have at least
20 had a copy of the proposal, whether it was signed or
21 not.

22 Q At the bottom of the April 17th letter from
23 Mr. Coltman it says, enclosures. Was one of the
24 enclosures typically a proposal for design and
25 installation?

1 A No.

2 Q Do you remember discussing the \$50,000
3 payment at that first meeting?

4 A No.

5 Q Moving back a few pages in the document to
6 the section called drafting of plan documents, the last
7 line there, Menke & Associates will work with you and
8 your counsel to prepare the necessary corporate minutes,
9 committee minutes and stock purchase agreement. Do you
10 recall if Menke & Associates did, in fact, serve those
11 functions for the Paint ESOP?

12 A Yes.

13 Q And for the KMH ESOP when CIG was brought
14 in as well?

15 A Yes.

16 Q And for the CIG portion of that as well?

17 A Yes.

18 Q And that was an additional cost; correct?

19 A Correct.

20 Q Do you remember what the additional charge
21 to the company was for those -- for those services?

22 A No, no, I do not.

23 Q And Menke & Associates was retained by the
24 company; correct?

25 A Correct.

John Menke

Confidential

March 21, 2008

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1 Q And not by the ESOP; correct?

2 A Correct.

3 Q Was anyone representing the ESOP
4 independently in this transaction, if you know?

5 MR. PALMER: Object to the form.

6 A Not that I know of.

7 BY MR. JACKSON:

8 Q At any point was Menke & Associates
9 providing services for the ESOP?

10 A I guess that gets into opinions or --

11 Q Let me restate it.

12 A We provided administration as a contract
13 administrator but that's to the company. We were
14 engaged by the company to administer the recordkeeping
15 for the ESOP.

16 Q Other than that did -- other than
17 administration for the ESOP that the company hired Menke
18 & Associates to do, was there any other services that
19 Menke & Associates provided directly to the ESOP?

20 MS. DILLER: Object to the form.

21 A Yeah, first we didn't say that we provided
22 those services to the ESOP. And I don't think of any
23 other services. I can't think of any other -- of any
24 services that we provided to the ESOP.

25 BY MR. JACKSON:

1 BY MR. JACKSON:

2 Q Looking at No. 3 on that document, which is
3 on page 3, item No. 3, the first line of that is there
4 is no pending or to the best of our knowledge threatened
5 action, suit, or proceeding or any other order, writ,
6 judgment, award, injunction, or decree against or
7 affecting the ESOP before any court, governmental agency
8 or arbitrator.

9 Do you see that?

10 A Yes.

11 Q Did you understand that Kelly-Moore had a
12 number of asbestos lawsuits pending against it as of
13 October 13th 1998?

14 MS. DILLER: Assumes facts not in
15 evidence.

16 BY MR. JACKSON:

17 Q I am asking if you know.

18 A I did not know.

19 Q You didn't know that?

20 A I did not.

21 Q Did Mr. Moore tell you that?

22 A No.

23 Q Did anybody tell you that there had been
24 thousands of claims made against Kelly-Moore at that
25 point?

1 MS. DILLER: Assumes facts not in
2 evidence. Argumentative.

3 BY MR. JACKSON:

4 Q I am asking.

5 A No one told me.

6 Q Do you know if anybody told Mr. Coltman?

7 A I wouldn't know.

8 Q Why wouldn't you know?

9 A How would I know if they told Mr. Coltman?

10 Q Did you ask Mr. Coltman to review this
11 letter before you sent it?

12 A No, Mr. Coltman's not a lawyer.

13 Q In order to make the representations in
14 this letter, who did you talk to?

15 A First of all, relied on the company's
16 financial statements and, secondly, representations from
17 Mr. Ferrari.

18 Q Anyone else?

19 A Not that I recall.

20 Q Did Mr. Ferrari tell you that the company
21 had asbestos lawsuits pending against them?

22 A No.

23 Q Did Mr. Moore tell you that at any point?

24 A No.

25 Q When did you first find out that

1 Kelly-Moore had problems with asbestos litigation?

2 A Several years later.

3 Q When you say several years, later than
4 2000?

5 A I don't know when I first heard about it,
6 but it was this was '98, '99, 2000 -- probably 2001 or
7 2002.

8 Q So nobody told you before the 1998
9 transaction?

10 A No.

11 MS. DILLER: Mischaracterizes testimony.

12 BY MR. JACKSON:

13 Q Nobody told you before the 1999 CIG
14 transaction either?

15 MS. DILLER: Mischaracterizes testimony.

16 A I will repeat again, I did not know of any
17 asbestos litigation until 2001 or 2002.

18 BY MR. JACKSON:

19 Q Who told you in 2001 or 2002 that there
20 were problems with asbestos litigation at Kelly-Moore
21 Paint?

22 MR. PALMER: Object to the form.

23 A I don't recall who I first heard it from.
24 All I recall, it was indirectly. I didn't hear it from
25 the company.

1 them what was going on?

2 A No.

3 Q Why not?

4 A I wasn't the contact person. Victor Alam
5 would be the one who would -- was the lawyer on the
6 case.

7 Q Did you talk to Victor Alam about
8 Kelly-Moore's asbestos liability when you found out
9 about it in 2001 or 2002?

10 A Well, I put it the other way around. I
11 think he brought it to my attention.

12 Q I see.

13 A But whether he was the first to bring it to
14 my attention or not, I don't know.

15 Q Do you know how he found out?

16 A I don't.

17 Q Did you talk about it with Kyle Coltman?

18 A Not that I recall.

19 Q Do you remember what you and Mr. Alam
20 talked about with regard to Kelly-Moore's asbestos
21 liability in 2001 or 2002?

22 MR. PALMER: Object to the form.

23 A I don't.

24 BY MR. JACKSON:

25 Q Would you have changed your representation

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1 in No. 3 if you knew about asbestos lawsuits that had
2 been filed against Kelly-Moore Paint?

3 MR. PALMER: Object to the form.

4 MS. DILLER: Calls for speculation.

5 MR. LOVITT: Object to form.

6 MS. DILLER: Rank speculation.

7 A Yeah, I really can't say what I would have
8 done. It's speculative. I, you know -- might have
9 depended on how much insurance coverage they had, the
10 level of claims, whole series of issues. I don't know
11 what I -- you know, can't say what I would have done or
12 said. I mean, clearly if they had claims that were not
13 being covered by insurance, that would have been in the
14 financial statements, and then clearly I could not have
15 or would not have given the opinion then.

16 BY MR. JACKSON:

17 Q So you think it should have been covered by
18 the financial statements?

19 MR. PALMER: Object to the form.

20 MR. LOVITT: Form of the question.

21 MS. DILLER: Mischaracterizes testimony.

22 A Yeah, I am just saying if it had been
23 stated differently in the financial statements, that
24 would have affected my opinion.

25 BY MR. JACKSON:

1 Q And what would have needed to be in the
2 financial statements for your opinion to be effective?

3 MR. LOVITT: Object to the form of the
4 question.

5 A As an example, if the financial statements
6 had a paragraph that I have seen in a few other cases
7 that said the company has claims that are of the sort
8 that we cannot estimate and may have damages that are,
9 you know, subject the company to uncertain financial
10 statements or financial history, then obviously I would
11 not have been able to give an opinion.

12 MR. LOVITT: Move to strike. Sorry.

13 BY MR. JACKSON:

14 Q Would you have done your --

15 MR. LOVITT: Move to strike.

16 MR. JACKSON: I heard the move to strike.

17 MR. LOVITT: You did but the important
18 lady didn't.

19 BY MR. JACKSON:

20 Q Would you have done your own due diligence
21 on the level of asbestos liability before writing
22 paragraph 3 if you had known that it was material?

23 MR. PALMER: Object to the form of the
24 question.

25 MR. LOVITT: Object to the form. Calls

1 was done with no letter update?

2 A Probably would be.

3 Q And why?

4 A Well, because the regulation requires that
5 there be a letter as of the date of the transaction,
6 actually.

7 Q Is there any other reason that you would be
8 concerned?

9 A Well --

10 MS. DILLER: Vague and ambiguous.

11 A -- I mean, the purpose of the regulation is
12 to make sure that the transaction is still fair. So the
13 concern is that the valuation could have changed in the
14 interim between the date of the last appraisal and the
15 transaction date.

16 BY MR. JACKSON:

17 Q I am going to ask you now to take a look at
18 a document which we will mark 52, which is MK 3534
19 through 3549.

20 (Exhibit No. 52 marked
21 for identification.)
22

23 Q This may be a fairly short set of
24 questions. Do you recognize the handwriting on the
25 first page of that document?

1 A Yes.

2 Q Whose is it?

3 A It's Jack Brooks.

4 MS. DILLER: I'm sorry. What was the
5 answer to the question?

6 THE WITNESS: Jack Brooks.

7 BY MR. JACKSON:

8 Q By Jack Brooks you mean B.J. Brooks?

9 A B.J. Brooks.

10 Q Same person?

11 A Right.

12 Q Have you seen Mr. Brooks' working notes on
13 valuations before?

14 A Yes.

15 Q Have you seen this document before?

16 A You mean this particular document?

17 Q Yes, sir.

18 A Yeah, it was in the documents in your
19 subpoena.

20 Q I see. What do you understand this
21 document to be?

22 A These are his notes from talking with
23 somebody at the company, presumably Steve Ferrari, but I
24 have no idea how many people were involved. But these
25 are his notes from either a meeting or a telephone

1 conference where he's gone through with his sort of
2 checklist of due diligence.

3 Q Did you discuss these notes with him?

4 A No.

5 Q I am going to now ask you to take a look at
6 a document MK 1141 through 1143 which we will mark as
7 53.

8 (Exhibit No. 53 marked
9 for identification.)
10

11 A Yes.

12 Q Have you seen that document before?

13 A Yes.

14 Q When did you see it?

15 A Well, this particular document again was in
16 the documents in your subpoena.

17 Q Prior to producing it to us, have you seen
18 it -- prior to producing it to plaintiffs, have you seen
19 it?

20 A I'm sure I have somewhere. Can't say when.

21 Q Do you know if did Mr. Brooks run this by
22 you before he sent it to Kelly-Moore?

23 A Well, the document was prepared by Kyle
24 Coltman.

25 Q I see. Did Mr. Coltman run it by you

EXHIBIT 41

Menke & Associates, Inc.
Corporate Financial Consultants

Mendham, New Jersey

*114 Sansome, Suite 1000
San Francisco, California 94104-3821
(415) 362-5200
Fax (415) 362-3268*

RECEIVED

APR 20 1998

April 17, 1998

PERSONAL AND CONFIDENTIAL

Mr. Bill Moore, Chairman
Kelly-Moore Paint Co.
987 Commercial Street
San Carlos, CA 94070

Dear Bill:

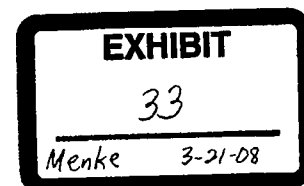
I enjoyed meeting you and Joe on Wednesday and I look forward to possibly designing and implementing the ESOP for Kelly-Moore Paint Co. I think an ESOP would be very valuable for you and your employees and thus have prepared the enclosed materials as our proposal for the design and installation of an ESOP for Kelly-Moore Paint Co. (the "Company").

As we discussed, an ESOP provides a natural and economical way for you to cash in your investment in the Company on a tax-advantaged basis, ultimately pass control to the next generation of management, and simultaneously tie each employee's long-term compensation to the success of the Company. Properly designed, an ESOP is advantageous to you, to successor managers, to the Company, and to the employees.

Benefit to Selling Shareholder

As the seller, you would realize some—or eventually all—of your investment in the Company tax free, provided that you observe the requirements for tax-free rollover: A seller is permitted to elect tax-free treatment for the transaction that puts the ESOP trust over the 30% ownership hurdle and for all subsequent transactions of whatever size. If you eventually sell your entire 100% interest worth an estimated \$600 million, the resulting diversified investment portfolio would be more than \$150 million larger than with a taxable sale. The proceeds of the sale must be reinvested in stocks or bonds of American operating companies, either public or private.

I have assumed that the ESOP would initially borrow \$180 million and purchase 30% of the outstanding stock. After several years, it is probable that the initial borrowing could be sufficiently paid down to permit the ESOP to finance a second transaction, which would enable you to sell some more of your interest tax free.



Menke & Associates, Inc.

Mr. Bill Moore
April 17, 1998
Page 2

Benefit to the Company

From the Company's perspective, an ESOP sale draws upon pretax profits rather than after-tax dollars. Thus, an ESOP is inherently 34% (+ state tax) easier on the Company's cash flow than other ways of cashing out an owner, virtually all of which draw upon after-tax cash.

For each \$1 million of stock purchased, therefore, the Company must earn only \$1 million pretax, whereas a nondeductible redemption or key employee bonus buyout would require about \$1.6 million of pretax earnings.

Confidentiality Preserved Each Year. Salaries, bonuses, ownership perks are not disclosed.

I should also point out that no disclosure of confidential information is required; the employees simply receive their individual account values. The employees do not have to see the balance sheet or profit/loss statements or even the appraisal.

Control

From your perspective, control does not change. You may elect yourself to be a one-person ESOP Committee, thereby voting all the stock in the ESOP for as long as you wish. An ESOP permits voting control to remain in the hands of the current controlling individuals for the indefinite future. Initially, the shares in the ESOP will be voted by a plan committee appointed by the current Board of Directors. When you choose to appoint a successor manager or management team to the Plan Committee, control over the ESOP shares passes to the next generation.

Benefit to Successor Managers: Ownership

Menke & Associates, Inc. recommends that successor managers own enough stock in the Company to guarantee their commitment to the Company. If projections indicate that currently owned shares and their ESOP accounts would be insufficient, we may recommend creating a supplementary management stock bonus plan.

Menke & Associates, Inc.

Mr. Bill Moore
April 17, 1998
Page 3

Benefit to Employees

Menke's experience with over 1,500 ESOP companies and published studies clearly show the benefits of ESOPs for employees as well. By financing the transition of ownership in the most economical way, employee-owned companies retain more capital for long-term growth. A cogent employee communications program, one that helps the employees to understand how they can make the Company more profitable, can have dramatic effect on productivity, profitability, and stock price. And both of these effects now benefit not only the founding shareholder, but the new employee shareholders as well. If the Company's payments to buy you out average 15% of payroll annually, a long-term employee will earn ownership equivalent to 150% of annual compensation, plus growth, over a ten-year period.

In summary, it appears that the ESOP could be structured to accomplish your various objectives. You will have established a true employee incentive plan, inasmuch as the value of the Company's shares is tied to the efforts of the participants of the ESOP. The ESOP also enables you to sell your shares to the ESOP tax-free, and all voting control would still continue under existing arrangements. Furthermore, the cash flow of the Company could also be enhanced.

The Next Step

If the enclosed proposal is of interest to you, we should arrange another meeting or have another phone conversation together. In the meantime, if you have any questions, please feel free to call me at (800) 347-8357 or (415) 362-5200.

Sincerely,

MENKE & ASSOCIATES, INC.



Kyle Coltman
Chief Executive Officer

KC:js

Enclosures